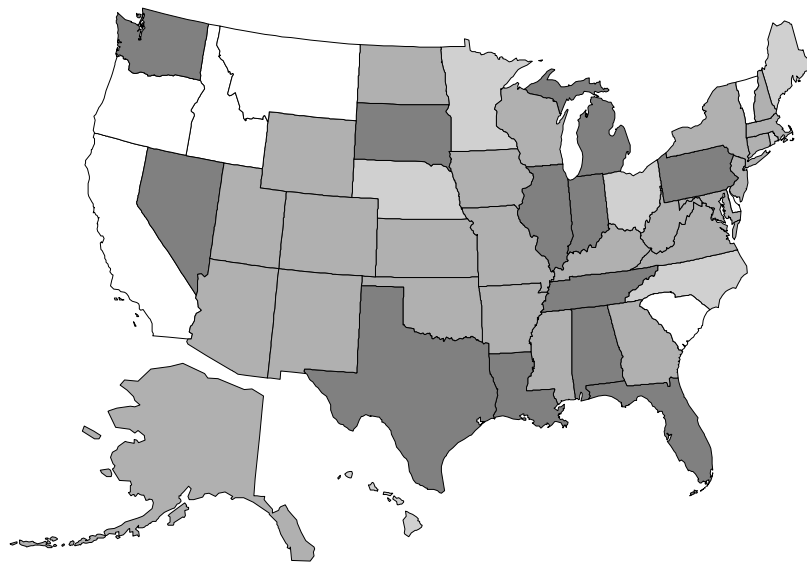


# Who Pays?

A Distributional Analysis of the  
Tax Systems in All 50 States



Citizens for Tax Justice

and

The Institute on Taxation & Economic Policy

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## Who Pays?

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“**D**evolution” is the term commonly used to describe the process by which the responsibilities of government are being shifted from federal to state and from state to local governments. Much attention has been paid to the impact this shift may have on the services government provides. But if state and local governments are to continue to provide the services they have in the past, and provide the new high quality services that the public demands, the discussion will inevitably turn to taxes. With state and local governments being called upon to do—and pay for—more and more, it is time to take a close look again at who pays for state and local government services.

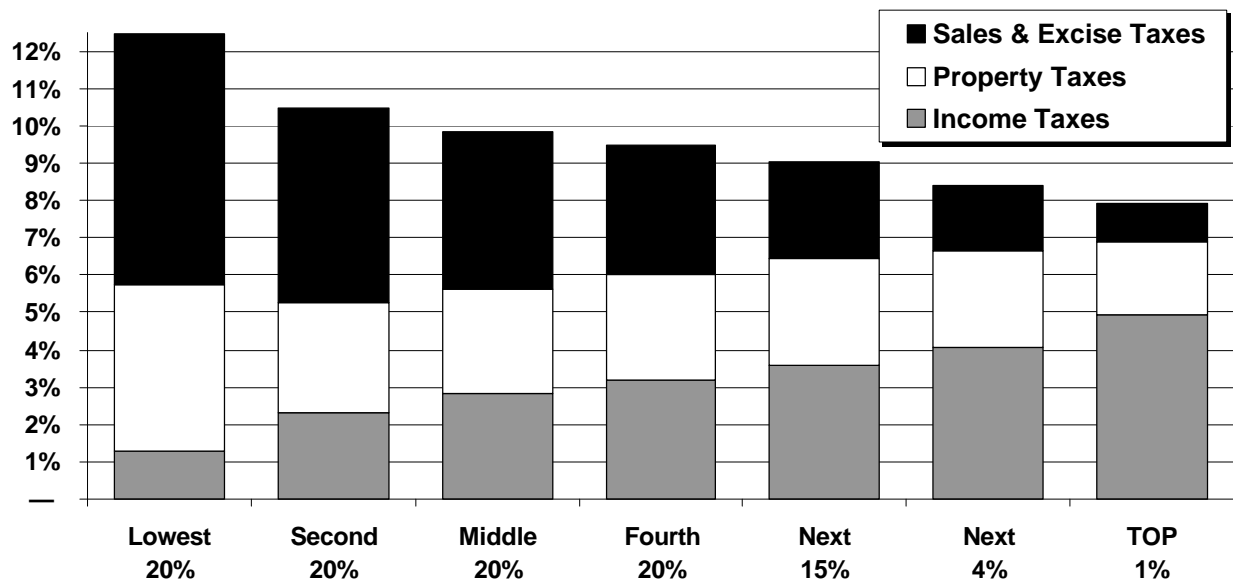
This study looks at taxes paid by income group, as shares of income, for every state and the District of Columbia. Our primary finding is that by an overwhelming margin, most state and local tax systems take a greater share of income from middle- and low-income families than from the wealthy. That is to say, most state tax systems are regressive.

In fact, only eight states require their best-off citizens to pay an equal or higher share of their incomes in taxes than middle-income families have to pay. Only four states tax their wealthiest at the same or higher effective rates than the poor. The disparities in effective tax rates between middle- and low-income families and the well-off are not trivial. In fact, most states tax the wealthy at rates that are significantly lower than the rates on middle- and low-income families.

# The average state and local tax on the best-off one percent of all families is 7.9%. The average tax rate on the poorest 20 percent of all families is substantially higher, at 12.5%. The average tax on families in the middle 20% of the income spectrum is 9.8%, a rate one-quarter higher than the rate on the rich.

## Average State & Local Taxes in 1995

State & local taxes imposed on own residents as shares of family income



# The 10 Most Regressive Tax States

Ten states—Washington, Florida, Texas, South Dakota, Tennessee, Pennsylvania, Louisiana, Illinois, Alabama and Michigan—are particularly regressive. These ten states ask poor families—those in the bottom 20% of the income scale—to pay two to four times as great a share of their earnings in taxes as do the wealthy. Middle-income families pay one-and-a-half to three times as high a share of their income as the wealthiest families.

The Ten Most Regressive State Tax Systems					
Taxes as shares of income by family income group					
Income group	Taxes as a % of Income on			Poor/ Top 1%	Middle/ Top 1%
	Poorest 20%	Middle 60%	Top 1%		
Washington	17.1%	10.5%	3.9%	435%	267%
Florida	14.0%	7.7%	3.6%	390%	216%
Texas	13.8%	8.5%	4.4%	314%	194%
South Dakota	11.7%	7.7%	2.9%	408%	269%
Tennessee	12.3%	7.5%	3.6%	340%	208%
Louisiana	13.4%	9.9%	6.0%	224%	167%
Pennsylvania	13.3%	10.2%	6.1%	220%	168%
Illinois	13.6%	9.8%	6.1%	223%	160%
Alabama	11.6%	9.0%	4.8%	242%	187%
Michigan	13.3%	10.6%	6.9%	193%	154%

## Low Tax States?

Some of these regressive tax states have been characterized as “low-tax” by the media or by their elected officials. But this raises the question: “low tax” for whom? Many analyses of tax burdens in the states simply rank states according to some computation of average tax burdens—sometimes looking only at selected taxes. But these averages often mask disparities among the taxes faced by families at different income levels.

Are no-income-tax states like Washington, Texas and Florida “low-tax” states for poor families? No. In fact, for people whose incomes place them among the poorest twenty percent of state residents, these states’ disproportionate reliance on sales and excise taxes make the tax burden very high.

### Ten States with the Highest Taxes on the Poor

Washington	17.1%
New York	16.2%
New Jersey	15.9%
New Mexico	15.0%
Florida	14.0%
Texas	13.8%
Wisconsin	13.7%
Illinois	13.6%
Louisiana	13.4%
Pennsylvania	13.3%

The table on the facing page shows the ten states that tax poor families the most. The state of Washington, which does not have an income tax, is the highest-tax state in the entire country for poor people. In fact, when all state and local sales, excise and property taxes are tallied up, poor families in the State of Washington pay 17.1 percent of their total income in taxes. Compare that to neighboring Idaho and Oregon, where the poor pay 9.2 percent and 10.9 percent, respectively, of their incomes in state and local taxes—far less than in Washington.

Florida and Texas, other no-income-tax states, tax their poor families at rates of 14 percent and 13.8 percent, respectively (fifth and sixth highest in the country). These rates on the poor are much higher than the rates on the poor in several states that some might brand as “big taxers.”

Many so-called “low-tax” states are, in fact, high-tax states for the poor. Most of them do not offer a good deal to middle-income families either. The wealthy in such states, however, pay relatively little.

## What Makes a State’s Tax System Regressive?

**W**hat characteristics do states with particularly regressive tax systems have in common? Looking at the 10 most regressive tax states, several items particularly stand out:

- # Five of the ten states lack a broad-based personal income tax.
- # Of the five very regressive tax states that do have broad-based personal income taxes, three have flat rate taxes and two (Alabama and Louisiana) allow a deduction for federal taxes paid.<sup>1</sup>
- # Seven of the ten states—Washington, Florida, Texas, South Dakota, Tennessee, Louisiana and Alabama—rely very heavily on sales and excise

Characteristics of the Most Regressive Tax Systems		
	Personal Income Tax	Heavy Use of Sales & Excise Taxes
	Little or None	Other Details
Washington	✓	✓
Florida	✓	✓
Texas	✓	✓
South Dakota	✓	✓
Tennessee	✓	✓
Louisiana		Fed. Ded.*† ✓
Pennsylvania		Flat Rate
Illinois		Flat Rate
Alabama		Fed. Ded.* ✓
Michigan		Flat Rate

\*Allows state tax deduction for federal income taxes paid.  
†Deduction partially offsets effects of quite graduated rates.

<sup>1</sup>A deduction for federal personal income taxes paid saps a state personal income tax of its progressivity. The federal personal income tax is progressive, taxing the wealthy more heavily than middle- and low-income taxpayers. Thus, a deduction on the state income tax for federal income tax paid is worth more to the wealthy.

taxes. In these seven states, about half to three-quarters of the total state and local taxes imposed on the families in our study come from these consumption taxes (compared to the national median of 35% for all states).

## The Least Regressive States

As we have seen, a flat income tax or no income tax at all, plus high sales and excise taxes, are what make for a very regressive tax system. But, what are the common characteristics among the least regressive tax states? Not surprisingly, the four least regressive states (those that by some measures have progressive tax systems) have progressive personal income taxes and do not rely heavily on consumption taxes. Of the four, Delaware and Montana have no general sales taxes, California has the most progressive income tax in the country and Vermont has the fourth most progressive income tax in the country and relatively low reliance on sales and excise taxes.

Characteristics of the Least Regressive Tax Systems			
	Personal Income Tax		Low Use of Sales & Excise Taxes
	Very Progressive	Other Details	
Delaware		High reliance	✓
California	✓		
Montana	✓	High reliance	✓
Vermont	✓	Ref. Credits*	✓
*Refundable credits are allowed even if they exceed a low-income family's income tax liability.			

## The Kind of Tax Matters

As can be seen by our analysis of the most and least regressive tax states, the kind of taxes that a state imposes on its citizens makes a real difference. As the table on the next page illustrates:

- # State and local income taxes are typically progressive. On average, poor families pay only a fourth the effective income tax rate that the richest families pay, and middle-income families pay about three-fifths the effective rate on the well-to-do.
- # Property taxes, including both taxes on individuals and business taxes, are usually somewhat regressive.
- # Sales and excise taxes are very regressive. On average, poor families pay more than six times as high a share of their income in these consumption taxes as do the best-off families, and middle-income families pay at four times the rate of the wealthy.

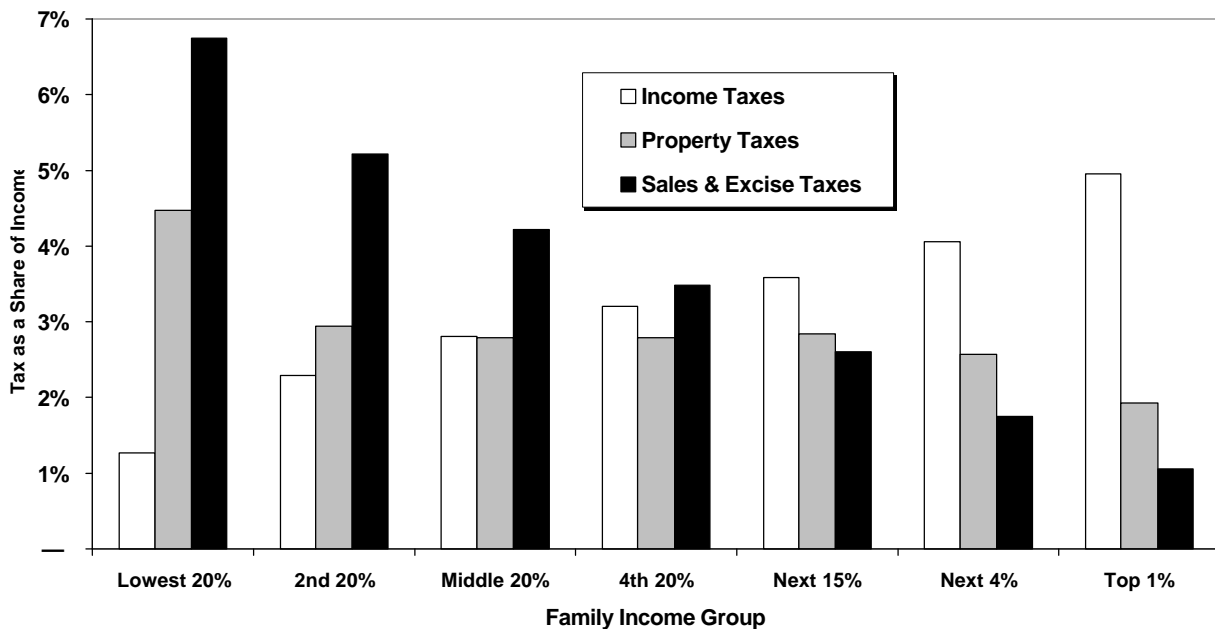
The relative regressivity of a state's overall tax system depends on two factors. First,

of course, is how each tax affects families at different income levels. But the second factor is also important: how large a role each tax plays in a state's overall revenue mix.

Thus, California's level of reliance on each of its major taxes is fairly typical. But, by having a very progressive personal income tax, it ends up with one of the most progressive tax systems in the country.

Delaware, on the other hand, is one of the most progressive tax states not because any one of its taxes is exceptionally progressive, but because it relies so heavily on its modestly progressive income tax and relies very little on regressive sales and excise taxes.

## Comparing Taxes: Averages for All States



## Income Taxes

State personal income taxes—and their counterpart, corporate income taxes—are the chief progressive element of state and local tax systems. In fact, it is difficult to design an income tax system that is not at least somewhat progressive. That's largely because the choices that are made in devising an income tax are generally explicit ones—unlike, say, sales taxes, where the distributional consequences may not be immediately obvious.

For example, it would be hard to imagine a state implementing an income tax in which statutory tax rates fell as income rose. And, in fact, no state explicitly does that—most at least purport to do quite the opposite. The level of graduation, or progressivity, in state income tax rates varies widely. Some states, such as California and Vermont, have significant graduation in their tax rates. Others have flat rates or only nominal graduation. And a very few states, such as Alabama and Pennsylvania, have what amounts to regressive rate structures by some measures. For example:

# In California, the bottom marginal income tax rate of 2 percent starts at about \$23,000 in income for a family of four and gradually rises with income, up to 11



percent for families making more than about \$500,000. (This top rate on the very well-off expires in 1996, however).

- # Vermont and Rhode Island calculate their personal income taxes as a percentage of the federal income tax. As a result, their systems share the same progressivity as the federal system. Rates in Rhode Island, for example, start at 4.1 percent of family income above \$16,550 for families of four, and gradually increase to as high as 10.9 percent on families making more than about \$300,000.
- # Maryland is a good example of a state with nominally graduated income tax rates that don't mean very much in practice. Maryland's state statutory rates go from 2 percent to 5 percent, but the top rate kicks in at only \$3,000 in taxable income. (There is also a local Maryland income tax that, on average, is 54 percent of state liability).
- # Alabama's top income tax rate of 5 percent starts at only \$6,000 in taxable income. In addition, Alabama allows a deduction for both federal income taxes and its own state income tax. As a result, real marginal tax rates in Alabama actually fall off at higher income levels. For families with taxable incomes greater than \$275,000, the marginal state income tax rate is effectively down to less than 3 percent.

In addition to the rate structure, deductions, exemptions and tax credits affect who pays the taxes. Connecticut, for instance, has a flat rate but large exemptions and credits that are phased out at higher income levels. Although this does not make Connecticut's one of the most progressive income taxes by any means, it does keep it off the least progressive list where most of its flat tax brethren can be found.

Several states give low-income working families a percentage of the federal Earned Income Tax Credit. Other states have low-income tax credits of their own design. When these credits are available even if they exceed a family's income tax liability (i.e., they are "refundable"), the income tax rate at lower incomes can actually be negative.

The following two tables show states whose personal income taxes are notably progressive, or which notably lack progressivity. The tables illustrate how progressive income taxes typically produce considerably lower taxes for most families compared to non-progressive ones.<sup>2</sup>

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<sup>2</sup>It's useful to note that a high degree of income tax progressivity does not imply a high level of overall income taxes. Of the six states with particularly progressive income taxes, none is near the top or bottom in terms of their total income tax as a share of income. One is exactly at the median; two are slightly above; and the remaining three are below. Likewise, of the seven states with little or no income tax progressivity, two are well above the median in terms of their total income tax as a share of income; three are well below; and the remaining two are just above and just below the median.

Also worth noting are two states with very narrow-based income taxes, Tennessee and New Hampshire. These states limit their personal income taxes to interest and dividends. Not surprisingly, these taxes are quite progressive. But they also raise only a tiny amount of revenue.

<b>Six States with Quite Progressive Personal Income Taxes</b>				
<b>Income taxes as shares of income by family income group</b>				
<b>Income group</b>	<b>Lowest 20%</b>	<b>Middle 60%</b>	<b>Top 1%</b>	<b>Notes</b>
California	0.1%	1.8%	8.2%	Highly graduated rates—for now
New Mexico	−0.8%	1.9%	5.8%	Graduated rates; refundable credits*
Rhode Island	0.6%	2.6%	7.1%	% of federal tax; refundable credits*
Vermont	−0.2%	2.2%	6.0%	% of federal tax; refundable credits*
Idaho	−0.1%	3.2%	6.3%	Highly graduated; refundable credits*
Maine	0.5%	3.0%	6.5%	Highly graduated rates

\*Refundable credits are allowed even if they exceed a a low-income family's income tax liability

<b>7 States with Little or No Personal Income Tax Progressivity</b>				
<b>Income taxes as shares of income by family income group</b>				
<b>Income group</b>	<b>Lowest 20%</b>	<b>Middle 60%</b>	<b>Top 1%</b>	<b>Notes</b>
Alabama	1.8%	3.1%	2.5%	Virtually flat; federal deduction
Pennsylvania	2.4%	3.5%	3.0%	Flat rate
Indiana	2.7%	3.3%	3.2%	Flat rate
Illinois	1.7%	2.5%	2.5%	Flat rate
Michigan	2.4%	3.7%	4.1%	Flat rate
Maryland	3.2%	5.4%	6.0%	Virtually flat
Massachusetts	2.9%	4.8%	5.6%	Flat rate system by income type*

\*Different flat rates on various kinds of income.

## Sales & Excise Taxes

**S**ales and excise taxes are the central regressive element of most state and local tax systems. Because graduated rates are next to impossible in a sales tax, and because spending as a share of income falls as income rises, sales taxes inevitably take a larger share of income from low- and middle-income families than they take from the rich. Thus, while a general sales tax may appear on its face to be a “flat-rate” tax, that is not really its practical impact. Even before exemptions for particular kinds of goods and services, a sales tax begins by exempting all unspent income. Since the rich are able to save a much larger portion of their incomes than middle-income families—the poor can rarely save at all—the tax is inherently regressive.

In addition, although most states exempt necessities such as food and shelter, most also exempt various kinds of services that constitute a major portion of the spending of the better off.

Taxing groceries is a particularly regressive element of many state sales taxes. In fact, of the dozen most regressive general sales tax states in the country, ten apply their sales tax to groceries.

The bottom line is that, on average, poor families pay more than six times as great a share of their incomes in state sales and excise taxes as do rich families, and middle-income families pay four times as great a share of their income in these consumption taxes as do the rich.

<b>The 12 Most Regressive General Sales Taxes</b>				
<b>Sales taxes as shares of income by family income group</b>				
<b>Income Group</b>	<b>Sales Tax on Individuals</b>			<b>Sales Tax on Groceries?</b>
	<b>Lowest 20%</b>	<b>Middle 20%</b>	<b>Top 1%</b>	
Tennessee	6.0%	4.1%	1.0%	✓
Louisiana	7.6%	5.4%	1.3%	✓
Arkansas	5.3%	3.5%	0.8%	✓
Georgia	4.5%	2.8%	0.7%	✓
Florida	4.4%	3.0%	0.7%	
Missouri	4.7%	3.0%	0.7%	✓
New Mexico	7.3%	4.9%	1.4%	✓
Mississippi	5.6%	3.9%	0.9%	✓
California	4.2%	2.7%	0.7%	
Oklahoma	4.6%	3.1%	0.8%	✓
Alabama	4.1%	2.6%	0.6%	✓
Utah	4.7%	3.5%	0.8%	✓

Sales taxes are, by definition, a percentage of the price of a fairly broad base of taxable goods and services (although tax bases do vary substantially from state to state). Excise taxes are imposed on a narrow band of goods, typically ones for which demand has a practical per-person maximum (e.g., one can only use so much gasoline). Thus, wealthy people don't buy more of the product no matter how much money they may have. Moreover, excise taxes are typically based on volume rather than price, e.g., per gallon, per pack, and so forth. So better-off people pay the same absolute tax on an expensive premium beer as low-income families pay on a run-of-the-mill variety. As a result, excise taxes are usually the most regressive kind of tax.

Appendix IV shows the distributional effects, state-by-state, of three of the leading state excise taxes—those on gasoline, cigarettes and beer. Overall, these taxes take about 1.3 percent of the income of poor families, 0.6% of the income of families in the middle and only 0.1% of the income of the very best-off. That means that these excise taxes are 15 times tougher on the poor than on the rich and 7½ times harder on middle-income families than on the rich. Whatever non-tax-policy claims may be offered for these kinds of taxes, their extremely regressive distributional consequences should not be ignored.

# Property Taxes

**T**he property tax, mostly on real estate, but in many states also on automobiles, business machines, and even (although rarely) on intangible assets such as stocks and bonds, is typically the main source of revenues for local governments.

The property tax is a kind of wealth tax, but one that usually focuses on a subset of total wealth: homes and business real estate. Our analysis shows that, overall, the property tax is a regressive tax—albeit far less regressive than sales and excise taxes. That result stems from several sources:

- # For average families, a home represents the lion's share of their total wealth. At high-income levels, however, homes are only a small share of total wealth. Because the property tax concentrates on homes, it applies to most of the wealth of middle-income families, but only a small share of the wealth of the rich.
- # For homeowners, home values as a share of income tend to decline at higher incomes. Thus, a typical middle-income family's home might be worth double the family's annual income, while a rich person's home might be valued at one-and-a-half times annual income.
- # Property tax on residential rental property passed through to renters in the form of higher rent is a much larger share of total income at low-income levels than at high-income levels. This adds to the regressivity of the property tax (we treat half of the property tax on residential property as passed to renters and half as paid by property owners in this study. See the methodology appendix for more information).

The regressivity of the property tax is mitigated by its business component, which generally falls on owners of capital, and is, to a significant degree, “exported” to residents of other states. On average, we found that about 43 percent of a typical state's property taxes fall on business (excluding the portion of apartment taxes that we assigned to renters).

The regressivity of property taxes is dependent on both the design of the tax and housing patterns in the state. The states with the least regressive property taxes do, however, tend to have several features in common:

## Homestead Exemptions

A homestead exemption excludes from taxation a certain amount of home value. Louisiana has the kingfish of homestead exemptions, excluding the first \$75,000 of value from most taxation. With such a large exemption, it is only those who can afford valuable homes that pay substantial homeowner property tax. The exemption is the reason that Louisiana has the only progressive property tax. Five of the six least regressive property tax states have homestead exemptions.

## Low Income Credits

A common form of tax relief is a credit against property tax based on income. Many states provide such relief, but often only for the elderly. Some of these credits are called “circuit-breakers.” A circuit-breaker gives relief proportional to the amount by which property taxes exceed a percentage of income. Hawaii has low-income property tax credits that make its property tax less regressive.

## Taxation of Intangible Assets Like Stocks and Bonds

A few states tax intangible assets owned by individuals. Although these taxes are not very large, and have been notorious for being evaded in many states, they do add to the progressivity of the property tax because the well-off own a large share of intangible assets. Three of the six least regressive property tax states tax individually-owned intangibles.

Six States with the Least Regressive Total Property Taxes				
Property taxes as shares of income by family income group				
Income group	Lowest 20%	Middle 60%	Top 1%	Notes
Louisiana	1.1%	0.6%	1.1%	Very large homestead exemption
Georgia	2.8%	1.8%	2.0%	Homestead exemption & intangibles tax*
South Carolina	2.3%	1.5%	1.7%	Homestead exemption
Hawaii	1.9%	1.2%	1.1%	Homestead exempt. & low-income credit
Kentucky	2.2%	1.6%	1.3%	Intangibles tax
Alabama	1.7%	1.1%	1.0%	Homestead exemption

\*Note: Georgia's intangibles tax has been repealed, starting in 1996.

## Federal Itemized Deduction Offset

State and local personal income and property taxes, unlike sales and excise taxes, are allowed as itemized deductions in computing federal income taxes. This has a far more significant impact than is sometimes appreciated. On average, a fifth of all state personal income and individually-paid property taxes are “exported” to the federal government (and to taxpayers nationwide) as a result of these deductions. For the best-off state and local taxpayers, close to 40 percent of their state and local income and property tax bills are effectively paid by the federal government.

For example, if a wealthy family pays \$5,000 in state personal income tax, it gets a deduction from its federal taxable income of \$5,000. In other words, the family gets to pay federal tax on \$5,000 less income. If the family is in the top federal bracket of 39.6%, its federal tax is reduced by  $0.396 \times \$5,000$ , or \$1,980. That means that the net cost to this family of \$5,000 in state personal income tax is only about \$3,000. The federal government pays for the rest in reduced collections.

Federal itemized deductions for income and property taxes benefit both the affected individuals and the states, which see a portion of their income and property taxes paid for by the federal government instead of coming out of the pockets of their citizens.

In the tables later in this study, the benefit of the federal deduction is shown by income group. Wealthier taxpayers benefit more because they are in higher federal marginal tax brackets and because they are more likely to have enough deductions to itemize.<sup>3</sup>

## Business climate and related issues

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One could imagine a state official thinking in the back of his or her mind that maybe, just maybe, regressive taxes could have a salutary effect. If wealthy people pay much lower effective tax rates than ordinary families, perhaps that could encourage the well-off to invest and create jobs in a state. Maybe high taxes on the poor and low taxes on the rich could lead to fewer poor citizens and more rich ones, rather than simply poorer poor people and richer rich people.

The evidence, however, does not support this theory. There is simply no correlation between the regressivity of a state's tax system and a state's income level or income growth. Both the ten most regressive states and the ten least regressive have about the same average per-capita personal incomes, and both had about the same average per-capita personal income growth rates over the past seven years. Indeed, each of these groups was, on average, about the same in both categories as states in the middle of the pack.

To be sure, there are substantial variations among states in per-capita incomes and growth rates, but these do not correlate at all with the level of regressivity of a state's tax system.

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<sup>3</sup>The federal itemized deduction offset is a significant benefit to state government and many of their citizens, but it effectively makes state tax systems even more regressive. In fact, after accounting for tax savings from federal itemized deductions for state and local income and property taxes, every single state imposes lower effective tax rates on the rich than middle- and low-income families have to pay.

# Not a single state asks its richest citizens to pay more than 9 percent of their income in total state and local taxes after federal itemized deduction offsets. In contrast, all but 7 states require their poorest families to pay effective tax rates in excess of 9 percent. And almost two-thirds of all states require middle-income families to pay more than 9 percent (even after federal itemized deduction offsets).

# After federal deductions, the average state and local tax on the richest one percent of all families is only 5.8%. The average tax rate on the poorest 20 percent of all families is more than double that, at 12.5%. The median tax on families in the middle 20% of the income spectrum is 9.4%, almost two-thirds higher than the rate on the rich.

# Conclusion

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**A**s a great debate about the proper size and role of the federal government proceeds, the demand for quality government services from state and local governments continues to grow. As new responsibilities devolve to the states, important decisions will have to be made on how to pay for fulfilling them.

To date, state and local governments have chosen not to tax those who can best afford it at the same levels that middle- and low-income families are asked to pay. This study marks a point from which the future of state and local taxation can be measured. States may choose to pay for new services in the same way that they have in the past—regressively. Or they may decide instead to ask wealthier families to pay tax rates more commensurate with their incomes. In either case, the path that states choose will have a major impact on the well-being of their citizens—and will be a major part of the devolution story.

**Appendix I:**  
**Detailed**  
**State-by-State**  
**Tables**



**C**itizens for Tax Justice was founded in 1979 to inform the public about tax issues and to give average taxpayers a voice in Washington, D.C. Since then, CTJ has earned a reputation for timely, reliable analytical work. CTJ studies such as *Corporate Income Taxes in the Reagan Years* (1984) and *The Failure of Corporate Tax Incentives* (1985) have been widely cited by analysts and relied on by policy makers. These and similar CTJ studies helped set the stage for the major overhaul of the federal tax code in the 1986 Tax Reform Act.

CTJ's analyses of state and local taxes, including *The Sorry State of State Taxes* (1986) and *A Far Cry From Fair* (1991), have proven to be valuable tools for state legislators, governors and activists around the nation.

**T**he Institute on Taxation & Economic Policy has engaged in research on tax issues since 1980, with a focus on the distributional consequences of both current law and proposed changes. ITEP's research has often been used by CTJ in its studies, and ITEP is frequently consulted by government estimators in performing their official analyses.

For the past several years, CTJ and ITEP have worked together on an ambitious project to build a microsimulation model of the tax systems of the U.S. government and of all 50 states and the District of Columbia.

**The Institute on Taxation & Economic Policy Microsimulation Tax Model** is based on a very large sample of federal tax returns, Census microdata, Consumer Expenditure Survey microdata and information from other data sources, encompassing 690,000 statistically-matched records, selected to produce reliable results on a state-by-state basis. The ITEP Model includes all significant current national, state and local tax laws, and is equipped to evaluate changes to those laws. This study reflects the results of the years of effort it took to build the ITEP Model.

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